

Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable. See 86 Ill. Adm. Code 130.1935(a). (This is a GIL.)

September 21, 2004

Dear Xxxxx:

This letter is in response to your letter dated April 21, 2004, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

By means of this letter, ABC is formally requesting a private letter ruling on the taxability of an invoice that represents sales of physical and electronically delivered software.

ABC is a public independent software company. ABC and its subsidiaries produce and sell computer software and provide a broad range of consulting, education and technical support services to customers throughout the world. ABC's product offerings primarily focus on enterprise infrastructure software. In many instances, the price charged for each product depends upon the number of product users to which products may be deployed. In general, the Company sells most of its software "out of the box" although occasionally, the company will provide implementation services associated with its software that might include a degree of customization.

Under the Company's business model, it sells customers perpetual software licenses to its products. Currently, physical software is delivered to the customer using a third party shipper. Upon initial purchase of software, a maintenance support plan is usually required for the first year. Maintenance support entails bug fixes, enhancements, new releases combined with telephone support, which is renewed on a yearly basis. For most bundled maintenance products, updates and telephone support are priced together and are not sold separately. However, initial purchases of software and

bundled maintenance support are invoiced on one invoice, but itemized and priced separately.

Currently, software and support are delivered on a tangible media (e.g., a computer disk or CD-ROM). In the future, the Company will have the ability to deliver its software and support (i.e., updates and bug fixes) via electronic downloads through the Internet.

Facts

1. Current customers who have purchased software prior to 2003 have received the original software and all subsequent updates on a tangible medium.
2. With the initial purchase of the software license, support is mandatory and is separately stated on the invoice.
3. Subsequent software support is optional. It should be noted, however, that should the customer choose not to renew its support contract for the second year, but then chooses to renew the support contract in the third year, he must pay for both second and third year support to bring his software to the current version.

Issues

1. Is the purchase of software taxable when delivered solely over the Internet:
 - a) If it is the initial purchase of a product?
 - b) If it is the purchase of the ability to deploy additional users to a previously purchase of product?
 - c) If it is the purchase of the ability to deploy additional users to a **previously physical** purchase of product?
2. Is mandatory bundled support (i.e. future bug fixes, enhancements, new releases combined with telephone support) taxable when purchased with electronically delivered software?
3. Does the fact that the initial software is itemized separately from the bundled maintenance support and priced as individual lines on one invoice impact taxability of the two products?
4. If a customer purchases multiple software products and support plans with the use of no product purchased dependant upon any other product purchased, and requests that certain products be delivered electronically and others physically using a third party shipper:
 - a) If a single invoice itemizes each product, would the State recognize the products delivered electronically as exempt and the products delivered on a physical media as taxable?
 - b) Based on our business model of mandatory support with the initial purchase of software, if an invoice reflects mixed deliveries, how would the mandatory support be taxed?

We ask for the state to rule on the taxability of optional software support that includes the right to updates delivered solely through electronic means, so that we can be prepared to tax the product appropriately when this business change is made.

Should you require any additional information please do not hesitate to contact me.

Thank you in advance for your assistance in this matter. We look forward to your response.

DEPARTMENT'S RESPONSE

Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of 86 Ill. Adm. Code 130.1935. Sales of software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See subsection (c)(3) of 86 Ill. Adm. Code 130.1935.

Custom computer programs prepared to the special order of the customer are not subject to liability under the Retailers' Occupation Tax, Use Tax, Service Occupation Tax or Service Use Tax. See 86 Ill. Adm. Code 130.1935(c). To be considered exempt software, the following elements must be present:

- A) Preparation or selection of the program for the customer's use requires an analysis of the customer's requirements by the vendor; and
- B) The program requires adaptation by the vendor to be used in a specific work environment, e.g., a particular make and model of a computer using a specified input or output device.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement,

supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Please note that the license agreements in which the customer electronically accepts the terms by clicking ("I accept") do not comply with the requirement of a written agreement signed by the licensor and customer. In order to comply with the requirements as set out in (a)(1) of Section 130.1935 you must have a written "signed" agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. But, if the maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software. See 130.1935(b).

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Edwin E. Boggess
Associate Counsel

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